



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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IN REPLY REFER TO

PSP 730.4.25

15 May 2000  
00-PSP-044(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA**  
**DIRECTOR, FIELD DETACHMENT, DCAA**

**SUBJECT: Audit Guidance for Evaluation of Government Property and Material in the Possession of Contractors**

For the Department of Defense (DoD) to achieve an unqualified audit opinion on its financial statements, there are many financial reporting issues that need to be resolved. Property and material in the possession of contractors is one of these issues. Because of our ongoing audit presence at most of the defense contractors possessing government property, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) has asked for DCAA's assistance in quantifying these issues. Included as Enclosure 1 is a memorandum from the DoD Deputy Chief Financial Officer (CFO) expressing his appreciation to DCAA for agreeing to provide this assistance.

**BACKGROUND**

The Chief Financial Officers (CFO) Act of 1990, as expanded by the Government Management Reform Act of 1994, mandated important reforms in federal financial management to promote greater accountability in managing the finances of the federal government. Among those reforms are requirements for the preparation and audit of individual financial statements for the federal government's 24 largest department and agencies. The DoD represents one of the departments required to prepare financial statements.

DoD is committed to taking positive and effective measures to improve its financial management processes and systems and correct known systemic deficiencies. To accomplish this, DoD has adopted a two-tracked approach. One track is a long-term approach, which addresses improvements or replacement of current systems throughout DoD to meet the requirements of new government-wide accounting standards. The expected completion date is 2003 at the earliest. The second track, a short-term interim approach, aggressively addresses the most significant known deficiencies in the financial management process.

In a June 1998 letter to the Secretary of Defense, the Office of Management and Budget (OMB) listed a number of material deficiencies in DoD's Fiscal Year (FY) 1997 financial statements, as identified by the audit community (the DoD Inspector General and the General Accounting Office). DoD's property, plant and equipment (PP&E) was one of the primary deficiencies identified. In support of the DoD mission, DoD maintains airports and shipyards,

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depots and maintenance facilities, research facilities and laboratories, hospitals, commissaries, schools, and various types of housing facilities. To operate such activities requires extensive amounts of PP&E. DoD has PP&E that is valued at nearly a trillion dollars and is located throughout the world.

In October 1990, the Comptroller General, the Secretary of the Treasury, and the Director of the OMB agreed to establish the Federal Accounting Standards Advisory Board (FASAB) to consider and recommend accounting standards and principles for the federal government. Those standards and principles are published as Statements of Federal Financial Accounting Concepts and Standards.

In November 1995, the FASAB issued Statement of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant and Equipment." SFFAS No. 6 established four categories of PP&E: General PP&E, National Defense PP&E, Heritage Assets, and Stewardship Land.

General PP&E consists of tangible assets including land, that meets the following criteria: (1) an estimated useful life of 2 years or more, (2) not intended for sale in the ordinary course of operations, (3) acquired or constructed with the intention of being used, or being available for use by the entity, and (4) not consumed in use or a component of a higher assembly. General PP&E also includes assets acquired through capital leases, including leasehold improvements; property owned by the reporting entity in the hands of others; and land rights. General PP&E is further divided into two categories: real property and personal property. Real property includes land, building and other structures. Personal property includes equipment, furniture, vehicles, computers, and software.

National Defense PP&E consists of weapon systems and weapon systems related items. Heritage Assets are unique items that have historical, natural, cultural, educational, artistic or architectural significance. Stewardship Land is all land owned by the federal government that was previously public domain or donated to the government and includes land purchased by the federal government which was/is not acquired for, or used in connection with, General PP&E items (e.g., military installations and national parks). DCAA will not review Heritage Assets or Stewardship Land.

SFFAS No. 6 established the reporting requirements for General PP&E. General PP&E is to be recorded at acquisition cost and depreciated. Costs necessary to bring assets into fully operational condition (i.e., the costs of freight, handling and storage, and installation) also are required to be included in the recorded costs. When the historical cost of existing General PP&E assets is not available, estimates are required. Estimates are based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition.

The reporting requirements for National Defense PP&E are contained in SFFAS No. 8, "Supplementary Stewardship Reporting." Under SFFAS No. 8, the acquisition costs of National

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Defense PP&E are considered an expense and, therefore, the costs are not capitalized and not placed on the Balance Sheet. SSFAS No. 8 requires that DoD report either the historical costs or the latest acquisition costs of National Defense PP&E in a Supplementary Stewardship Report accompanying its annual financial statements. These costs are to be reported by major types. However, since the FASAB currently is considering changing the reporting requirements for National Defense PP&E, DoD has not yet implemented those requirements. Rather DoD is reporting quantities (as opposed to costs) of National Defense PP&E in a Supplementary Stewardship Report.

Another area of financial reporting that DoD found needed improvement was the area of Operating Materials and Supplies (OM&S). OM&S is comprised of material furnished to the contractor by the DoD as well as material purchased directly by the contractor, under the terms of the contract. Typically, OM&S in the possession of contractors will be incorporated into an end item or consumed in the performance of the contract. Contractors may also have other materials classified as OM&S, such as materials that are to be repaired and returned to DoD, and materials (such as munitions) that are being stored for DoD. Currently, DoD is having difficulty determining the total value of OM&S in the possession of contractors.

SSFAS No. 3 established the reporting requirements for OM&S. OM&S are to be categorized as (1) OM&S held for use, (2) OM&S held in reserve, or (3) excess, obsolete and unserviceable OM&S. SSFAS No. 3 requires the consumption method of accounting be used for OM&S. The consumption method accounts for goods, such as OM&S, where the goods are recognized as assets upon acquisition and are expensed as they are consumed (i.e., issued to an end user for consumption in normal operations). The OM&S are to be valued at historical cost, including normal purchase and production costs incurred to bring the items to their current condition and location.

DoD employs thousands of property managers and logisticians to safeguard its PP&E and OM&S and ensure proper accountability. However, accountability for PP&E is quite different than accounting for PP&E. Accountability requires safeguarding the PP&E and OM&S from loss, destruction or improper use and maintaining the PP&E in an acceptable, operable condition. Accounting for PP&E and OM&S requires recording acquisition costs, acquisition dates, disposal dates, depreciation (for PP&E), and maintaining the documentation supporting such transactions. Under the CFO Act, accounting for PP&E and OM&S must be given the same level of emphasis as has been given to accountability in the past.

Neither the accountability nor accounting requirements for most of the DoD's General PP&E assets and OM&S is accomplished through DoD financial systems. Instead, DoD relies on its property management and logistics systems to provide the financial information needed for the annual financial statements. However, these systems were not designed to be accounting subsidiary ledgers. As a result, reporting financial information from such systems is very difficult and problematic. For example, the DoD property management systems contain all General PP&E for accountability purposes, however DoD financial reporting only requires reporting of General PP&E greater than or equal to the DoD capitalization threshold (\$100,000)

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that has not exceeded DoD standard recovery periods (useful lives) as prescribed in the DoD Financial Management Regulation (Volume 4, Chapter 6).

In addition, a large amount of DoD's General PP&E, National Defense PP&E and OM&S are in the possession/custody of contractors. The defense contractors are required to submit annual reports on Form DD 1662, "DoD Property in the Custody of Contractors." These reports summarize the value of DoD property in the possession of contractors, and their subcontractors, in the following categories:

<b>General PP&amp;E (Real Property)</b>	<b>Description</b>
Other Real Property (ORP)	Utility distribution systems, buildings, structures and improvements thereto (e.g. warehouses, storage facilities, and hangars). (See FAR 45.505-14(a)(2))
<b>General PP&amp;E (Personal Property)</b>	
Other Plant Equipment (OPE)	Plant equipment regardless of dollar value, used in or in conjunction with the manufacture of components or end items relative to maintenance, research and development, etc. OPE excludes equipment categorized as IPE. (See DFARS 245.301)
Industrial Plant Equipment (IPE)	Plant equipment greater than \$15,000 used to alter the physical properties of materials, components or end items used for various operations (e.g., manufacturing, maintenance, etc.) (See DFARS 245.301)
Special Test Equipment (STE)	Either single or multi-purpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. (See FAR 45.101(a))
Special Tooling	Items which are of such a specialized nature that without substantial modification or alteration their use is limited to the development or production of particular supplies or parts thereof or to the performance of particular services (e.g., jigs, dies, fixtures, molds, etc.). (See FAR 45.101(a))
<b>National Defense PP&amp;E</b>	
Agency Peculiar Property	As used in DoD, means military property and includes end items and integral components of military weapons systems, along with the related peculiar support equipment which is not readily available as a commercial item. (See DFARS 245.301 and FAR 45.301)
<b>Operating Materials and Supplies (OM&amp;S)</b>	
Government Furnished Material (GFM)	Material in the possession of or directly acquired by the government and subsequently made available to the contractor. (See FAR 45.101)

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Contractor Acquired Material (CAM)	Material acquired or otherwise provided by the contractor for performing a contract and to which the government has title. (See FAR 45.101)
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DoD consolidates this contractor furnished information in the Contract Property Management System (CPMS), which included entries for over 16,600 contracts in FY 1999. However, the CPMS and the associated DD Form 1662 source documents include only summary PP&E and OM&S values by category by contract. In order for DoD to report the necessary financial information required under SSFAS No. 3, 6 and 8, more specific information is required, such as unit costs and acquisition dates.

The total value of DoD PP&E and OM&S reported in the CPMS for FY 1999 was approximately \$91 billion. Some of the information on both General PP&E and National Defense PP&E in the possession of contractors is maintained in the property management and logistics systems of the DoD Components. Therefore, DCAA's evaluation of Other Real Property and National Defense PP&E will be somewhat different than the other areas of review. In these areas we will be gathering information on selected items which will be used to test the accuracy of the DoD Components' systems.

DoD, along with representatives from the audit community, participated in a series of field visits to several major defense contractor plants. The visits revealed that most of the General PP&E (with the exception of Special Test Equipment and Special Tooling) in the possession of the contractors visited had a unit cost less than the DoD capitalization threshold or an acquisition date that would cause the capitalized items to be fully depreciated. The visits also identified problems with the accuracy of the material reported.

Based upon these findings, representatives from the OUSD(C) requested DCAA's assistance. The OUSD(C) would like a more detailed assessment of General PP&E in excess of the capitalization threshold that has not exceeded its useful life. As a part of our agreed-upon procedures the OUSD(C) has requested that we identify quantities of National Defense PP&E and improvements to Other Real Property (primarily at Government Owned Contractor Operated (GOCO) facilities). In addition, the OUSD(C) has requested our assistance in evaluating Operating Materials and Supplies (Government Furnished Material and Contractor Acquired Material) in the possession of contractors.

## **GUIDANCE**

### **Administrative Issues**

Included as Enclosure 2 is a pro forma letter to the contractor announcing the evaluation. The 4 April 2000 memorandum from the DoD Deputy CFO to DCAA should be included as an enclosure to this letter. The pro forma letter informs the contractor that all DD 1662s as of 30 September 1999 and supporting records originating from the contractor's location must be available for our evaluation. The letter also informs the contractor that we need the

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documentation supporting the DD 1662 in an electronic format. If the contractor states this is not possible, then request that the contractor invite one of its information system specialists to the entrance conference so we can further pursue the issue. Having the supporting information electronically, even if only for the prime contractor's data, will greatly facilitate our evaluation. It facilitates the use of Dollar Unit Sampling for selecting our sample and evaluating the results. In addition, the letter discusses the scope of our evaluation. Finally, the letter requests that the contractor provide a current listing of Agency Peculiar (National Defense PP&E) items in both the contractor's and subcontractor's possession.

Included as Enclosure 3 is a pro forma memorandum to the cognizant Commander (DCMA or Military Component) announcing the evaluation. The 4 April 2000 memorandum from the DoD Deputy CFO should also be included as an enclosure to this memorandum. This memorandum notifies the government property administrator of the evaluation, identifies the scope of our evaluation, and invites his/her attendance at the entrance conference. The memorandum also informs the property administrator of the oversight committee established by DoD to manage this project. Finally, the memorandum requests a meeting with the government property administrator to determine what records the government maintains relative to General PP&E and material. This meeting is important because it will help us gain an understanding of the contractor's policies and procedures relative to government property in their possession.

To support this evaluation, we established a team comprised of a representative from each region, Headquarters, and Field Detachment (see Enclosure 4). Your respective regional team member will assist in the logistics and the maintenance of uniformity of each evaluation. The regional representative is part of a team that is privy to the latest issues applicable to this evaluation. The regional team member will be at all entrance and exit conferences, and review all sample plans. If your regional team member cannot be present at the entrance and/or exit conference, coordinate with your regional representative to arrange having a team representative from Headquarters present. Any requests for agreed-upon procedures evaluations at subcontractor locations, both those within the region and those crossing regional boundaries, will be requested through your regional team member. Likewise, the results of the subcontractor evaluations will be provided to you through your regional team member. We are handling the subcontractor assistance requests in this manner to expedite the process. Therefore, once the sample selection is made and subcontractor items have been selected for evaluation, provide this information to your regional point of contact as soon as possible. The regional team member must be kept informed of any significant issues arising from the evaluations and will be responsible for coordinating these issues with both the applicable region and Headquarters. If the regional team member is unavailable, contact one of the Headquarters representatives.

A total of 31 contractor segments have been selected, either judgmentally or randomly, for evaluation. For the judgmentally selected contractor segments, an individual contract was selected for evaluation based upon the amount of National Defense PP&E or Other Real Property reported. For the randomly selected contractor segments, the segment was selected using Dollar Unit Sampling based upon the total government property (less other real property) reported by

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that segment. A listing of the contractors and/or contracts selected for evaluation is included as Enclosure 5 to this memorandum.

**Sampling Plan**

A separate statistical sample should be selected for each General PP&E and material category. If there are relatively few line items for a property or material type (e.g., OPE or GFM), it is recommended that you evaluate them in their entirety. Otherwise, if an electronic sampling frame is available, probability proportional to property line item amount (or Dollar Unit Sampling (DUS)) should be used. Without an electronic sampling frame, DUS is not practical, and stratified physical unit sampling (stratification by line item amount) is not likely to be practical either, leaving manual simple random physical unit sampling as the only alternative. An appropriate sample size is difficult to prescribe, however, for each property and or material type to be reviewed, a minimum of 20 items should be sampled. If manual sampling is used versus DUS, the sample size should be 20 in addition to any stratified large dollar items. All property and material types included in the contract(s) selected will be subject to evaluation. Therefore, it is possible to have six separate samples at a particular contractor segment. For example, if there are 12 contracts selected for evaluation, the Special Tooling for all 12 contracts would be included in the Special Tooling sampling universe. As noted above, a minimum of 20 items should be randomly selected from this universe for evaluation.

The individual items selected for evaluation at a particular contractor segment will depend on the nature of the sampling frame that can be obtained (or built) at that location. For each property and material type, the sampling frame at the contractor segment is the listing (electronic or hardcopy) of all the line items at that location. Ideally, an electronic sampling frame that includes all line items will be available so that the sampled items can be selected using EZQuant. If a consolidated listing is not available, the sampling frame could be built from files provided by the contractor. Least preferable is a situation where sampling frames are available only on hard copy, so that sampling must be performed manually and where simple random sampling would be required.

Because the prime contractor is required to report all PP&E and material in its possession, as well as its subcontractors' possession, part of the universe may have an electronic file sampling frame while another part may have a hard copy sampling frame. Every attempt should be made to obtain all information electronically, including the subcontractor's. If a hard copy sampling frame for a portion of the sampling universe is unavoidable, consider manually adding its information to the sampling frame that is electronically available. This will enable an automated sample selection for the entire sampling universe. If this is an impracticably large task, the sample must be stratified, one stratum for the electronic sampling frame and another stratum for the hard copy frame. That is, separate samples must be selected from the electronic file and the hard copy file, with the results of the evaluations reported separately. For sample sizing, first prorate the original sample size to the two strata on the basis of the stratum amounts. Then the hard copy stratum's sample size should be increased by 50 percent. The sample size is increased to offset the reduction in sampling

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efficiencies resulting from the shift to manual sampling. Lastly, if a stratum's sample size is below ten, it should be incremented to that level.

If the contractor can provide an electronic file on a real-time basis but not for 30 September 1999, the real time electronic frame should be used for sampling. DUS should be used to select the sample items. Along with the sample evaluation results, dollar value totals for the real-time file and the file as of 30 September 1999 should be reported so that adjustments can be made for changes in the property amounts between the two timeframes.

If the sampling frame must be hard copy, several large dollar items should be stratified for evaluation prior to selecting the random sample. This will have a beneficial effect on sampling precision and it will increase the number of items evaluated greater than \$100,000, a consideration important for General PP&E review purposes. As a general guide, prior to manual sampling, the auditor should manually scan the information for any items valued at close to or greater than 5% of the value of the total universe. Since these are stratified items, not sampled items, there should be no reduction in the number of items in the sample strata (i.e., the stratified items are in addition to the regular number of sampled items. When reporting the sample results, a distinction must be made between high value strata and the sample strata.

The auditor should not project the sample results. The sample results for each contractor segment will be brought together at Headquarters to calculate the overall projection and precision for each property type and for all property types combined.

**Agreed-Upon Procedures Evaluation Program Steps**

To facilitate the evaluation, Headquarters has developed an agreed-upon procedures evaluation program included as Enclosure 6 to this memorandum. The evaluation program outlines the preliminary, fieldwork, and concluding evaluation steps that should be performed at each contractor location. The evaluation steps were tested at five pilot sites to ensure they accomplished the desired objectives and that they could be accomplished in a reasonable amount of time. Throughout the evaluation program, references are made to Excel worksheets that are to be completed during the course of the evaluation. The Excel worksheets, and the instructions for completing the worksheets, are included as Enclosure 7 to this memorandum. In addition, the evaluation program includes a table detailing DoD's standard recovery periods for the different types of General PP&E. Detailed guidance on the areas is as follows:

**General PP&E.** As previously stated in the background section, General PP&E personal property falls into four categories: (1) Other Plant Equipment; (2) Industrial Plant Equipment; (3) Special Test Equipment and (4) Special Tooling. The objective for evaluating General PP&E is to develop estimated values for the various categories of General PP&E. For financial statement purposes, this would represent the value of items greater than \$100,000 that have not exceeded their useful life (generally 5 or 10 years depending upon the property).



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After examining the contractor's policies and procedures for valuing General PP&E, for each sampled item selected for evaluation: determine what support exists for the value reported on the DD 1662, analyze the amount for accuracy and completeness, and verify back to the source documents. When analyzing the amounts reported on the DD 1662 for accuracy and completeness, the auditor should ensure that all applicable costs were included. Such costs include amounts paid to vendors, handling and storage costs, labor and other direct or indirect production costs, etc. If all costs have not been included, and the information is readily available, the auditor should calculate the total costs. The auditor should also determine if any modifications have been made to the property and the accounting treatment given to these modifications, i.e., capital improvement or expense. Capital improvements are defined in the DoD Financial Management Regulation, Volume 4, Chapter 6, Paragraph 060205 A, which states, "Consistent with the SFFAS No. 6 'Accounting for Property, Plant and Equipment' costs to improve PP&E shall be capitalized only when the improvement increases a General PP&E asset's capacity, size, efficiency, or useful life." In addition, determine how the contractor came to have the property in its possession, specifically, it was (1) provided to the contractor, (2) acquired by the contractor, (3) fabricated by the contractor or (4) other (explain).

For all sampled items greater than \$100,000, verify the physical existence of the asset, identify the recorded acquisition date, and determine whether the asset has exceeded its useful life based upon DoD's standard recovery periods. If the auditor cannot physically verify the asset, the remaining steps should be completed and the worksheet (and the memorandum narrative) should be so annotated. The auditor should calculate the Net Book Value of any asset, or modification to the asset that has not exceeded its useful life. Generally, Special Test Equipment has a useful life of 5 years; Special Tooling, Other Plant Equipment and Industrial Plant Equipment 10 years. The auditor should also report the assets evaluated, by age using the applicable 5 or 10 year property category on the Headquarters provided "GPP&E Age Summary" Excel worksheet.

For all sampled General PP&E items, the auditor should record the DD 1662 reported amount, the amount determined through application of the agreed-upon procedures and the reason for the difference on the Headquarters provided "General PP&E" Excel worksheet. If an item has been misclassified (e.g., it was reported as Special Test Equipment when it is National Defense PP&E), identify this in the "Explanation" section of the same Excel worksheet.

Finally, the Comptroller's office has asked that wherever we have the contractor's information electronically, to use the electronic data to calculate for the total universe for each General PP&E category: (1) the number of items greater than \$100,000, (2) the total dollar value of the items greater than \$100,000, (3) the number of items greater than \$100,000 and less than 10 years old, and (4) the total dollar value of the items greater than \$100,000 and less than 10 years old, (5) the number of total items and (6) the dollar value of the total items. This information should also be reported on the "General PP&E" Excel worksheet.

**National Defense PP&E.** As part of its DD 1662 property accountability requirements, a contractor reports all Agency Peculiar (military property) in its possession. Agency Peculiar

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property is defined at FAR 45.301 as “government-owned personal property that is peculiar to the mission of one agency (e.g., military or space property). It excludes government material, special test equipment, special tooling, and facilities. Agency Peculiar property is synonymous with National Defense PP&E (except for the possible inclusion of (1) component parts sent for repair and supply or munition items in finished goods being stored, all of which are OM&S, or (2) the occasional piece of PP&E sent out for rework, e.g., a fire truck sent for overhaul or modification). As previously stated in the background section, the acquisition costs of National Defense PP&E are considered an expense and, therefore, the costs are not capitalized and not placed on the Balance Sheet. Rather, National Defense PP&E is reported in a Supplementary Stewardship Report. SSFAS No. 8 requires that National Defense PP&E be reported, at a minimum, by major type. DoD reports National Defense PP&E by the following categories:

1. Aircraft – combat, airlift, or other aircraft (e.g., trainer and experimental aircraft)
2. Ships – submarines, aircraft carriers, surface combatants, amphibious warfare ships, mine warfare ships, support ships, other ships (e.g., patrol or service craft), or small boats
3. Combat Vehicles – tanks or other combat vehicles
4. Guided, Self-propelled Ordnance Missiles (strategic and tactical)
5. Torpedoes (surface, air, and submarine launched)
6. Space Systems – satellites

Other items maybe identified as National Defense PP&E; however, the focus of the evaluation is on property items included in one of the seven categories above.

Our primary objective of the evaluation of the National Defense PP&E is to verify the existence of sampled high dollar National Defense PP&E and provide the Military Services, through the DoD Comptroller’s office, a current listing of sampled National Defense PP&E for verification to their logistics systems. The identifying information obtained on each sampled item should be included on the “ND PP&E List” Excel worksheet. If it is not feasible to verify all items, 10 items should be verified from the prime and subcontractor reported property. In addition, to test the contractor’s listing for completeness, when physically verifying the sampled items, select another National Defense PP&E item physically located near the sampled item for verification back to the contractor’s list. This step should be done for two of the sampled items. The results of the verification of these items should also be reported on the Excel worksheet, annotated that it was evaluated to test for completeness.

**Other Real Property Improvements.** As part of its DD 1662 reporting requirements, the contractor reports other real property in its and its subcontractors’ possession. Generally, this is at GOCO facilities. As a part of this, the contractor is required to report capital improvements as defined in the General PP&E section above. The Military Services should also be reporting this information in its Military Services’ real property databases. The objective of our evaluation is to identify capital improvements greater than \$100,000 that were made by contractors to government facilities for verification back to the Military Services’ databases. To accomplish this objective, after examining the contractor’s policies and procedures for identifying and

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reporting capital improvements to real property, contact the government property manager to identify improvements greater than \$100,000 during the last 20 years. If it is not feasible to verify all improvements, select a sample of 10 items for verification. Determine what support exists for the improvement, verify the physical existence of the property and obtain sufficient identifying information as detailed in the agreed-upon procedures evaluation program. Report the information on the “ORP List” Excel worksheet. The information contained in the Excel worksheet should be coordinated with the regional team member and provided to DCAA Headquarters, PSP, as soon as the list is finalized. Do not wait until the completion of the entire government property evaluation before submitting. In addition, for all identified improvements, summarize the cost of the improvements by year on the “ORP Age Summary” Excel worksheet. This worksheet should not be forwarded to Headquarters prior to completion of the evaluation.

**Operating Materials and Supplies (OM&S).** As previously discussed in the background section, OM&S is comprised of Government Furnished Material (GFM) and Contractor Acquired Material (CAM) in the contractor’s possession. In addition, some contractors may include component parts and munitions in OM&S, while other contractors may report these materials as Agency Peculiar property. GFM and CAM are defined as property that may be incorporated into or attached to a deliverable end item, or be consumed or expended in performing a contract. It includes assemblies, components, parts, raw and processed materials, and small tools and supplies that may be consumed in normal use for performance of a contract.

The objective for evaluating GFM and CAM is to verify that the material reported on the DD 1662 is properly valued, categorized, and verifiable to the Military Services’ records. The purpose for which contractors acquire material or receive government furnished material can vary. For example, material can be incorporated into an end product or consumed in the production or repair process. GFM, for example could be used for purposes discussed above, be sent to the contractor for repair, or the government could request that certain material be managed or stored for some DoD component to be use at a later date. For selected sample items of GFM and CAM, the auditor should determine the purpose for which the contractor has the material. The nature of the contract may help determine why the contractor has the item. For example, GFM or CAM on a production contract is likely to be for consumption into the end product. On a repair contract, the GFM could be the item to be repaired or could be used in the repair process.

After examining the contractor’s policies and procedures for valuing GFM and CAM the auditor should analyze the amounts recorded for the sampled items of CAM and GFM to determine what support exists for the value reported on the DD 1662, analyze the amount for accuracy and completeness, and verify the value back to source documents. In the case of GFM, the government should have provided the contractor with documentation (e.g., shipping invoice, etc.) that contains a unit price. If no such documentation exists, the auditor should determine what actions have been taken by the contractor to obtain the cost from the government, and what the contractor has used to estimate the value.

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For CAM, the auditor will analyze the amount reported on the DD 1662 for accuracy and completeness. The auditor should ensure that all applicable costs were included, such as labor, overhead, G&A and fee. For those items not fully burdened, the auditor should calculate an amount using the contractor's disclosed accounting practices. If items selected are several years old it may require an estimate using the current rates and factors. The fee should be calculated at a rate of ten percent. In any event, if the cost data is not readily available, the auditor should not spend excessive time trying to calculate or reconstruct the costs. The auditor should report that the cost reported for the item could not be verified and that sufficient data is not available to construct an amount to report.

Contractors may account for GFM and CAM as inventory, work-in-process, or finished goods. Some contractors do not report work-in process or finished goods on the DD 1662. If separately accounted for, the auditor should obtain a breakout by each area for all contracts reported.

The results of the evaluation of all sampled items should be reported on the Headquarters provided "Material" worksheet. For those GFM and CAM items identified as material managed or stored for the government or as component parts sent to a contractor for repair, the auditor should prepare a list of these items on the Headquarters provided "GFM List" or "CAM List" worksheets. The "GFM List" and "CAM List" worksheets should be provided to DCAA Headquarters, PSP as soon as they are finalized (prior to the completion of the entire evaluation). The lists will be forwarded to the Military Services, through the Comptroller's Office, for their verification in DoD Component Systems.

**Reporting**

As stated in the guidance above, the results of the evaluation should be reported on the appropriate Excel worksheets. In addition, included as Enclosure 8 is a pro forma memorandum to be used for reporting the results of the evaluation. When preparing the memorandum, the auditor should comment on the results of the review of the contractor's policies and procedures for the various property and material areas. In addition, the auditor should provide comments on any significant issues found during the course of the evaluation of each area.

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CONCLUDING REMARKS

If you have any questions please contact your regional team member. If unavailable, please contact Mr. Robert Flatt, Program Manager, or Ms. Susan Quinlan, Division Chief, Special Projects Division at (703) 767-3290, by fax at (703) 767-3234, or by e-mail at DCAA-PSP@dcaa.mil.

/Signed/

Lawrence P. Uhlfelder  
Assistant Director  
Policy and Plans

Enclosures

1. OUSD(C) Deputy CFO 4 April 2000 memorandum
2. Pro forma Letter to the Contractor
3. Pro forma Memorandum to the Commander (DCMA or Military Component)
4. Management Team Members
5. Listing of Contractor Locations
6. Audit Program
7. Excel Worksheets, and Instructions (*worksheets not available online*)
8. Pro forma Memorandum

DISTRIBUTION: B



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

APR 4 2000

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Property and Material in the Possession of Contractors

As you are aware, resolving the many financial reporting issues pertaining to Department of Defense (DoD) property and material in the possession of contractors is critical to successfully reporting the value of such assets on the Department's annual financial statements and achieving a favorable audit opinion from the government auditors. Achieving an unqualified audit opinion on the Department's annual financial statements is a DoD-wide high priority objective mandated by statute, emphasized by the President and Secretary of Defense and monitored by the Congress.

Utilizing the resources of the Defense Contract Audit Agency (DCAA) to assist in quantifying the issues pertaining to property and material in the possession of contractors, as well as assisting in developing the appropriate remedies, is the most effective approach for the Department to take in tackling this substantial task. Therefore, I am very grateful for the DCAA participation, the priority that the DCAA has placed on this effort and the quality of the individuals that the DCAA has assigned to this effort.

Without a doubt, the DCAA's timely success in accomplishing the objectives and tasks involved in this effort is dependent on the full and expeditious cooperation and support of the defense contractors that are selected as participants in the project. Therefore, a copy of this memorandum should be provided to such contractors to give them an appreciation of the purpose and importance of this effort.

Questions concerning this memorandum should be directed to Mr. Ken Schreier. He may be reached by e-mail: [schreiek@osd.pentagon.mil](mailto:schreiek@osd.pentagon.mil) or by telephone at (703) 693-5657.

Nelson Teye  
Deputy Chief Financial Officer

ENCLOSURE 1

## Proforma Letter for Contractor

[*Date*]

[*Contractor Name*]

[*Contractor Address*]

Subject: Evaluation of Government Property and Material in the Possession of [*Contractor Name*]

As stated in the attached 4 April 2000 memorandum from the Department of Defense (DoD) Deputy Chief Financial Officer (CFO), the Defense Contract Audit Agency (DCAA) has entered into an agreement with the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) to evaluate Property, Plant and Equipment (PP&E) and material in the possession of contractors. The DCAA effort will consist of an evaluation of the information submitted by contractors on the DD Form 1662, "DoD Property in Custody of Contractors" as of 30 September 1999. We plan to verify selected items supporting the amounts reported on the DD 1662s, including Other Real Property, General PP&E Personal Property, Agency Peculiar Property (classified as National Defense PP&E for financial statement purposes), and government material.

[*Contractor Name*] was selected for evaluation as part of this engagement based upon the information reported on the 30 September 1999 DD Form 1662(s). Based on this selection, we request that the following be made available by [*date*] for our evaluation:

1. The 30 September 1999 DD Form 1662s for all contracts (or for Contract [*no.*] if only one contract was selected for evaluation). In addition, please provide all subcontractor DD 1662s supporting the amounts reported.
2. The documentation supporting the amounts reported on the DD Form 1662(s) as of 30 September 1999. Please provide this information in electronic format. If the data is not available in electronic format, please provide it in hard copy. We also request that an information systems/information technology representative attend the entrance conference who is knowledgeable about the electronic aspects of the data.
3. A current listing of the National Defense PP&E in both your and your subcontractors' possession.

The scope of our evaluation entails (1) an examination of the policies and procedures that exist relative to your control and valuation of DoD PP&E and materials in your possession; (2) computation of net book values for General PP&E personal property for DoD financial statement purposes; (3) verification of quantities of National Defense PP&E currently in your possession; (4) verification of improvements to real property, and (5) verification of government furnished material (GFM) and contractor acquired material (CAM) for proper classification and valuation.

ENCLOSURE 2

Page 1 of 2

## Proforma Letter for Contractor

We would like to schedule an entrance conference on [*date*] at [*time*]. At that time, we may request additional data that may be needed. As stated in the DoD Deputy CFO's attached memorandum, "...DCAA's timely success in accomplishing the objectives and tasks involved in this effort is dependent on the full and expeditious cooperation and support of the defense contractors that are selected as participants in this project." Therefore, we appreciate your cooperation.

If you have questions concerning this letter, please contact me at [*phone number*], by fax at [*fax number*] or by e-mail at [*e-mail address*].

[*name*]  
Branch Manager

Enclosure  
DoD Deputy CFO 4 April 2000 Memorandum



## Proforma Memorandum for Commander, [DCMA or Military Command]

SUBJECT: DCAA Project to Evaluate DoD Property, Plant and Equipment

As stated in the attached 4 April 2000 memorandum from the Department of Defense (DoD) Deputy Chief Financial Officer (CFO), included as an enclosure to this memorandum, the Defense Contract Audit Agency (DCAA) has entered into an agreement with the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) to evaluate Property, Plant and Equipment (PP&E) and material in the possession of contractors. The purpose of the evaluation is to collect information on DoD property in the possession of contractors to assist the OUSD(C) in developing sound policies for financial statement reporting. To achieve this objective, using statistical sampling, we will assess the reliability of information recorded in the DD Form 1662, DoD Property in the Custody of Contractors. [**Contractor Name**] has been selected for evaluation.

The DCAA effort will consist of an evaluation of the information submitted by contractors on the DD Form 1662, "DoD Property in Custody of Contractors" as of 30 September 1999. We plan to verify selected items supporting the amounts reported on the DD 1662s, including Other Real Property, General PP&E personal property, Agency Peculiar (classified as National Defense PP&E for financial statement purposes) and government material.

The scope of our evaluation entails (1) an examination of the policies and procedures that exist relative to control and valuation of DoD PP&E and materials in the contractor's possession; (2) computation of net book values for General PP&E personal property for DoD financial statement purposes; (3) verification of quantities of National Defense PP&E currently in the contractor's possession; (4) verification of improvements to real property, and (5) verification of government furnished material (GFM) and contractor acquired material (CAM) for proper classification and valuation.

Also, DoD has established an oversight committee to manage this project. The committee is comprised of representatives from the OUSD(C), the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), the DCAA, the Military Departments, the Defense Contract Management Agency, the DoD Inspector General, and the General Accounting Office. This committee plans to meet on a regular basis throughout the course of the evaluation to discuss the status and address any overarching issues resulting from our evaluations.

You are invited to participate in an entrance conference to be held on [**date**] at [**time**]. We also would like to meet with you to determine what records the government maintains for General PP&E and government material. We may use these records to assist us in our evaluation.

If you have questions concerning this memorandum, please contact me at [**phone number**], by fax at [**fax number**] or by e-mail at [**e-mail address**].

[**name**]  
Branch Manager

Enclosure  
DoD Deputy CFO 4 April 2000 memorandum

ENCLOSURE 3

**Management Team for Review of Government Property and Material  
in the Possession of Contractors**

<b><u>Team Member</u></b>	<b><u>Telephone Number</u></b>	<b><u>e-mail</u></b>
Sue Quinlan, Headquarters, PSP, Team Leader	(703) 767-3290	Sue.Quinlan@dcaa.mil
Bob Flatt, Headquarters, PSP	(703) 767-3229	Bob.Flatt@dcaa.mil
Harry Huet, Central Region	(972) 753-2530	Harry.Huet@dcaa.mil
Jeff Fuller, Eastern Region	(770) 319-4450	Jeff.Fuller@dcaa.mil
Tom O'Donnell, Mid-Atlantic Region	(215) 597-5418	Tom.O'Donnell@dcaa.mil
John Delcore, Northeastern Region	(617) 450-0455	John.Delcore@dcaa.mil
Terry Nuzzo, Western Region	(206) 655-8818	Terry.Nuzzo@dcaa.mil
Pete Geissler, Statistician, Memphis	(901) 325-6214	Pete.Geissler@dcaa.mil

Item	RORG	FAO	Sample Selection Category	Cage Code	Contractor	City	State	Zip Code	Property Location	Contract(s) to Review
1	01191	Atlanta BO, Lockheed Martin Aero Sys SO	Stat Sample	98897	LOCKHEED AERONAUTICAL SYSTEMS CO	MARIETTA	GA	30063-0001	VARIOUS LOCATIONS	66 (all contracts)
2	01201	Huntsville BO, Birmingham SO	National Defense PP&E	91763	PEMCO AEROPLEX INC	BIRMINGHAM	AL	35212	BIRMINGHAM	F34601-94-C-0664
3	01211	Nashville BO, Kingsport SO	GOCO	1LF48	ROYAL ORDNANCE NORTH AMERICA INC	KINGSPORT	TN	37660-9982	HOLSTON AAP	DAAA09-98-E-0006
4	01461	Lockheed Martin Orlando RO	Stat Sample	04939	MARTIN MARIETTA TECHNOLOGIES INC	ORLANDO	FL	32855-5837	VARIOUS LOCATIONS	60 (all contracts)
5	01641	Dayton BO	National Defense PP&E	05HA6	CENTRAL OHIO AERO & TECH CENTER	HEATH	OH	43056-6117	HEATH	F42630-95-D-0686
6	01721	Newport News Shipbuilding RO	Stat Sample	43689	NEWPORT NEWS SHIPBUILDING & DRYDOCK	NEWPORT NEWS	VA	23607-	VARIOUS LOCATIONS	48 (all contracts)
7	01751	Gulf Coast BO	GOCO	2P154	MASON TECHNOLOGIES INC	STENNIS SPACE CTR	MS	39529-7099	MISSISSIPPI AAP, STENNIS SPACE CTR, MS	DAAA09-92-E-0007
8	02171	Boston BO, Mass Institute of Technology SO	Stat Sample	4X002	MASSACHUSETTS INST OF TECH	LEXINGTON	MA	02173-	VARIOUS LOCATIONS	F19628-95-C-0002 All (One Contract)
9	02361	General Dynamics RO, Bath Iron Works Suboffice	Stat Sample	70876	BATH IRON WORKS CORP	BATH	ME	04530-	VARIOUS LOCATIONS	17 (all contracts)
10	02701	Bay States BO, General Electric Lynn SO	Stat Sample	99207	GENERAL ELEC CO AIRCRAFT ENGINES	LYNN	MA	01910	VARIOUS LOCATIONS	25 (all contracts)
11	03201	St Louis BO	GOCO	1CV77	ALLIANT TECHSYSTEMS INC	INDEPENDENCE	MO	64050-	LAKE CITY AAP	DAAA09-91-Z-0009
12	03201	St Louis BO	GOCO	2D878	ALLIANT TECHSYSTEMS INC	DESOTO	KS	66018-	SUNFLOWER AAP, DESOTO, KS REPLACED CONTRACT DAAA09-86-Z-0001	DAAA09-92-Z-0010

13	03231	Salt Lake Valley BO	Stat Sample	10396	ALLIANT AEROSPACE	MAGNA	UT	84044-	VARIOUS LOCATIONS	18 (all contracts)
14	3531	Richardson BO	Stat Sample	2AAB5	RAYTHEON/HUGHES TRAINING	ARLINGTON	TX	76011-6382	VARIOUS LOCATIONS	3 (all contracts)
15	03421	Boeing St. Louis RO	Stat Sample	76301	MCDONNELL DOUGLAS CORP MCD AIRCRAFT	ST LOUIS	MO	63166	VARIOUS LOCATIONS	231 (all contracts)
16	03541	Minneapolis BO	GOCO	1BMT7	MASON AND HANGER CORP	CAVALIER	ND	58220	CAVALIER AS, ND	F05604-97-C-9004
17	03541	Minneapolis BO	Stat Sample	90536	LOCKHEED MARTIN NAVAL ELECTRONICS & SURVEILLANCE SYSTEMS	ST PAUL	MN	55116	VARIOUS LOCATIONS	31 (all contracts)
18	3761	Raytheon Missile System RO	National Defense PP&E/Stat Sample	15090	RAYTHEON MISSILE SYSTEMS CO	TUCSON	AZ	85734-1337	VARIOUS LOCATIONS	280 (all contracts)
19	03901	Arizona BO, Boeing MDHS SO	Stat Sample	8V613	BOEING CO	MESA	AZ	85205-9797	VARIOUS LOCATIONS	31 (all contracts)
20	04141	East Bay BO	GOCO	0NRD3	CABACO INC	SIERRA VISTA	AZ	85635	NV	F26600-95-C-0043
21	04151	San Diego BO, Nat'l Steel & Shp Bldg SO	Stat Sample	81220	NATIONAL STEEL & SHIPBUILDING CO	SAN DIEGO	CA	92138	VARIOUS LOCATIONS	4 (all contracts)
22	04231	San Fernando Valley BO	Stat Sample	63910	TRACOR FLIGHT SYSTEMS INC	AUSTIN	TX	78725	MOJAVE, CA	5 (all contracts)
23	04381	Boeing RO	Stat Sample	81205	BOEING AEROSPACE & ELECTRONIC	SEATTLE	WA	98124	VARIOUS LOCATIONS	104 (all contracts)
24	04461	Boeing Huntington Beach RO	National Defense PP&E	88277	MCDONNELL DOUGLAS CORP DOUGLAS ACFT	LONG BEACH	CA	90846-	ST.LOUIS,MO/REMO SITES/SUBCONTRACTOR	F33657-97-C-0008
25	04721	Northrop Grumman Corp RO	GOCO/National Defense PP&E/Stat Sample	1W025	NORTHROP GRUMMAN CORP	PICO RIVERA	CA	90660	VARIOUS LOCATIONS	12 (all contracts)
26	04901	San Gabriel Valley BO	National Defense PP&E	0BLG0	ITT FEDERAL SVS CORP	HAMPTON	VA	23666-0449	FT IRWIN CA	DAKF04-96-C-0012
27	04901	San Gabriel Valley BO, Aerojet Electronics Sys Div SO	Stat Sample	70143	AEROJET ELECTROSYSTEMS CO	AZUSA	CA	91702-	VARIOUS LOCATIONS	21 (all contracts)

28	06151	Fairfax BO	Stat Sample	54274	LOCKHEED MARTIN TACTICAL SYSTEMS	RESTON	VA	22091	VARIOUS LOCATIONS	14 (all contracts)
29	06201	Northern NJ BO	National Defense PP&E	094A5	BAY SHIP MANAGEMENT INC	ENGLEWOOD CLIFFS	NJ	07632	ENGLEWOOD CLIFFS	N62387-95-C-4002
30	06201	Northern New Jersey BO, ITT SO	Stat Sample	28527	I T T AVIONICS DIV	NUTLEY	NJ	07110-	VARIOUS LOCATIONS	22 (all contracts)
31	06501	Lockheed Martin Mt. Laurel RO, Lockheed Martin Services Inc. SO	Stat Sample	77609	LOCKHEED MARTIN SERVICES INC	CHERRY HILL	NJ	08358-0001	VARIOUS LOCATIONS	12 (all contracts)

**DEFENSE CONTRACT AUDIT AGENCY**

**EVALUATION PROGRAM FOR GOVERNMENT PROPERTY AND MATERIAL IN  
THE POSSESSION OF CONTRACTORS**

Contractor Name: \_\_\_\_\_

Assignment Number: \_\_\_\_\_

Field Audit Office \_\_\_\_\_

Date Assigned: \_\_\_\_\_

\_\_\_\_\_  
Supervisor's Signature Indicating Approval  
(Obtain Signature Before Starting Evaluation)

Auditor Assigned: \_\_\_\_\_

**A. PURPOSE AND SCOPE:**

1. Purpose. The purpose of the evaluation is to collect information on DoD property and material in the possession of contractors to assist the Office of the Under Secretary of Defense (Comptroller) in developing sound policies for financial statement reporting. Using statistical sampling, we will assess the information recorded in the DD Form 1662, DoD Property in the Custody of Contractors, to assist DoD in resolving financial reporting issues relative to government property.
2. Scope. The evaluation steps selected for completion, or added as necessary, represent a determination of the requirements based on auditor judgment and a clear understanding of the purpose of the evaluation.

<u>Staff Hours</u>		<u>Auditor</u>
<u>Budget</u>	<u>Actual</u>	<u>Initial</u>
		<u>Ref.</u> <u>&amp; Date</u>

**B. PRELIMINARY STEPS**

1. Review the MRD announcing the evaluation to determine the overall purpose and the types of contractor documentation needed to perform the required agreed-upon procedures evaluation steps.
2. Contact the contractor in writing using the pro forma letter enclosed in the MRD announcing this evaluation. The letter should also include the DoD Deputy Chief Financial Officer's memorandum to DCAA. The letter should include a request for the following information:

	<u>Staff Hours</u>		<u>Ref.</u>	<u>Auditor Initial &amp; Date</u>
	<u>Budget</u>	<u>Actual</u>		
a. The 30 September 1999 DD 1662 forms for all contracts.				
b. The documentation supporting the amounts reported on the DD 1662. If possible, obtain the documentation in an electronic format. If there is a significant difference between the documentation and the amount reported on the DD 1662 as of 30 September 1999, ask the contractor to explain the difference.				
c. A current listing of Agency Peculiar Property (ND PP&E) in the contractor's and its subcontractors' possession.				
d. A copy of the contractor's policies and procedures for accounting for government property.				
3. Contact the government property administrator in writing using the pro forma memorandum enclosed in the MRD announcing the evaluation. The memorandum should also include the DoD Deputy Chief Financial Officer's memorandum to DCAA.				
4. Contact the government property administrator to:				
a. Ascertain the types of analyses done on the contractor's DD 1662 submissions.				
b. Determine what support is maintained to document the analysis.				
c. Determine whether the information obtained in Steps 4.a. and 4.b. above may be useful in reducing effort under the evaluation.				
d. Ascertain the general location of the property reported on the property records that support the DD 1662.				
5. Hold an entrance conference with the contractor.				
6. Examine the contractor's policies and procedures for accounting for General Property, Plant and Equipment (PP&E) (General PP&E includes Other Real Property, Other Plant Equipment, Industrial Plant Equipment, Special Test Equipment and Special Tooling) and discuss with the contractor, to determine the following:				

- a. What information the contractor maintains for government owned property. Determine how the information is used to support the amounts reported on the DD 1662. Determine if the contractor's procedures provide the records required per FAR 45.505-1 as follows:
    - (1) The Name, Description, and National Stock Number (if furnished by the government or available in the property control system
    - (2) Quantity Received (or Fabricated), Issued, and on Hand
    - (3) Unit Price (and Unit of Measure);
    - (4) Contract Number of Equivalent Code Designation; Location;
    - (5) Disposition; and
    - (6) Posting Reference and Date of Transaction.
  - b. How General PP&E is valued in the contractor's property records. If the value of the General PP&E was initially based on an engineering estimate, is the amount ever adjusted to actuals? Is the amount ever adjusted based upon major changes to the item? (Particularly relevant for Special Tool and Special Test Equipment).
  - c. What is recorded as the acquisition date of the General PP&E in the contractor's records for contractor acquired or produced items? Is the date ever adjusted based on major changes to the items?
  - d. What is recorded as the acquisition date of the General PP&E for government furnished items. Is the date ever adjusted based on major changes to the items?
  - e. If the contractor possesses any government owned (non-licensed) software. If yes, determine what kind (e.g., government-unique (contractor maintained/ developed), or government-unique (government maintained)).
7. Examine the contractor's policies and procedures for accounting for Agency Peculiar Property (National Defense (ND) PP&E), and discuss with the contractor, where applicable, to determine the following:



- a. What criteria are used to define an item as Agency Peculiar (ND PP&E) on the DD 1662.
  - b. Where component parts sent to the contractor for repair by the DoD Component are reported on the DD 1662.
  - c. Where component parts or munitions that are being stored are reported on the DD 1662?
  - d. How Agency Peculiar (ND PP&E) is accounted for in the contractor's property records.
8. If the contractor identifies Other Real Property on the DD 1662, examine the contractor's policies and procedures for accounting for real property improvements, to determine the following:
- a. When repairs/improvements are to be capitalized versus when they are to be expensed.
  - b. How improvements are valued in the contractor's property records.
  - c. What is recorded as the acquisition date in the contractor's records for capitalization purposes.
  - d. If design costs are included in the cost of improvements.
  - e. Whether the contractor completes a DD 1354, Transfer and Acceptance of Military Real Property, for all improvements. If so, determine if the contractor records the DD 1354 information into a database. If so, determine if the contractor can provide a listing of all improvements to buildings that are selected for review. If the contractor does not complete the DD 1354, determine why.
9. Examine the contractor's policies and procedures for accounting for Contractor Acquired Material (CAM) and Government Furnished Material (GFM) and discuss with the contractor, to determine the following:
- a. The criteria the contractor uses to include items in CAM and GFM.

- b. At what point are the items no longer classified as CAM and GFM (e.g., when they enter the production process, when shipped to the Military Departments, etc.).
  - c. When consumable items are dropped from DD Form 1662 reporting.
  - d. If the contractor separately identifies CAM and GFM as inventory, work-in-process, and finished goods. If not, is the contractor's accounting system or property records capable of doing so. If not, explain why.
  - e. How the GFM is valued in the contractor's property records.
  - f. How the CAM is valued in the contractor's property records (i.e., does it include the appropriate loadings, e.g., material overhead, G&A, and fee?).
  - g. Determine how items sent to the contractor for repair are classified (e.g. government furnished material, Agency Peculiar property, etc.) and when the classification changes.
10. Document in the working papers the answers to each of the questions in steps 6 through 9 above, based upon the examination of policies and procedures and the discussions with the contractor.
  11. Develop a sampling plan for General PP&E, GFM and CAM, using an electronic file provided by the contractor. If electronic data is not available for Dollar Unit Sampling, use other statistical sampling techniques as appropriate. Follow the guidance in the MRD relating to this review and coordinate the sampling plan with the regional point of contact.

### **C. FIELD WORK**

1. General PP&E. If the contractor's supporting data was provided electronically, calculate the total amount of General PP&E, by category, that is greater than \$100,000 and less than 10 years old.

For those sampled items selected for evaluation:

- a. Determine what support exists for the value of the PP&E. Verify value back to source documents. If the sampled item is in the possession of a subcontractor, notify the regional point of contact.
- b. Determine whether the item was:
  - (1) furnished to the contractor,
  - (2) acquired by the contractor,
  - (3) fabricated by the contractor, or
  - (4) other (explain).
- c. Analyze the amount for accuracy and completeness, i.e., were all applicable costs (e.g., amounts paid to vendors; handling and storage costs; labor and other direct or indirect production costs [for assets produced or constructed]; etc.) and fee included. If all costs have not been included, and the information is readily available, calculate the total cost. Do not perform a cost study to determine the total cost.
- d. Determine if any modifications have been made to the item. Were the modifications greater than or equal to \$100,000? If so, determine if they were reported as a capital improvement. (If more than one improvement is made, and the improvements are part of one overall effort, the sum of the costs of the improvements should be capitalized if the total exceeds \$100,000, even if the efforts are separately funded.)
- e. For all sampled items evaluated, record the reported amount, amount determined based on application of the agreed-upon procedures, and the reason for the difference on the "General PP&E" Excel worksheet. Separately report any identified improvements. If an item has been misclassified, please identify so on the worksheet.
- f. For all General PP&E assets, or modifications to the assets, whose total costs are greater than or equal to \$100,000:
  - (1) Verify the physical existence of the asset.

- (2) Identify the recorded acquisition date. If the acquisition date is not available, attempt to determine the asset age by some other method, e.g., manufacture date. Based upon your observations, determine whether the recorded acquisition date appears to agree with the apparent physical age of the asset. (The manufacturer's tag on an item may be useful in estimating the physical age.)
- (3) Determine whether the asset has exceeded its useful service life per DoD's Schedules? (See Page 15 of 15 of this program for DoD Schedules.)
- (4) Calculate the Net Book Value of the asset.
- (5) Report the assets evaluated, in total for the contractor segment, by age using the applicable 5 or 10 year property category on the "GPP&E Age Summary" Excel Worksheet as follows:

<u>5 Year Property</u>			<u>10 Year Property</u>		
<u>Age of Asset</u>	<u>Qty.</u>	<u>Cost</u>	<u>Age of Asset</u>	<u>Qty.</u>	<u>Cost</u>
< 1 year			< 1 year		
> = 1, < 2 yrs.			> = 1, < 2 yrs.		
> = 2, < 3 yrs.			> = 2, < 3 yrs.		
> = 3, < 4 yrs.			> = 3, < 4 yrs.		
> = 4, < 5 yrs.			> = 4, < 5 yrs.		
> 5 years			> = 5, < 6 yrs.		
			> = 6, < 7 yrs.		
			> = 7, < 8 yrs.		
			> = 8, < 9 yrs.		
			> = 9, < 10 yrs.		
			> 10 years		

## 2. National Defense PP&E.

- a. Request from the contractor a current list of all Agency Peculiar Property (ND PP&E) in the contractor's possession.
- b. Stratify the larger dollar items for verification. Before proceeding, ensure the item selected falls into one of the following categories:
  - (1) Aircraft – combat, airlift, or other aircraft (e.g., trainer and experimental aircraft)
  - (2) Ships – submarines, aircraft carriers, surface combatants, amphibious warfare ships, mine

- warfare ships, support ships, other ships (e.g., patrol or service craft), or small boats
- (3) Combat Vehicles – tanks or other combat vehicles
- (4) Guided, Self-propelled Ordnance Missiles (strategic and tactical)
- (5) Torpedoes (surface, air and submarine launched)
- (6) Space Systems – satellites

Note: The above listing excludes some items such as support equipment that would be properly included as Agency Peculiar Property.

- c. Do a cursory review of the remaining lower dollar items to determine if an item falling into one of the categories above was improperly valued and reported.
- d. Select a sample of 10 items and perform the following steps:
  - (1) Verify the physical existence of the asset. If the sampled item is in the possession of a subcontractor, notify the regional point of contact. While verifying the existence of the sampled item, select 2 sampled items and identify another ND PP&E item located near the sampled item for verification back to the contractor-provided list to ensure all items have been reported by the contractor.
  - (2) Obtain the following information on the sampled item to allow identification by the DoD Component:
    - (a) Contractor Name
    - (b) Contract Number on DD 1662
    - (c) Property Owner
    - (d) National Stock Number (NSN)
    - (e) Nomenclature (description of item)
    - (f) Serial Number
    - (g) Identification Number
    - (h) Other Identifying Information
  - (3) Input data on the attached “ND PP&E List.” Excel worksheet. Provide the list of the verified National Defense PP&E (Agency Peculiar) to Headquarters, PSP, as soon as the list is finalized (prior to completion of the entire evaluation of government

property, if possible) to be forwarded to the Military Services, through the Comptroller's office, for their verification in the Acquisition and Logistics database.

3. Improvements to Real Property. If the contractor has reported other real property in its possession (line 11 of DD Form 1662), contact the contractor property manager to determine the following:
  - a. What the amount reported on the DD 1662 for Other Real Property (ORP) represents (e.g., original acquisition cost of the ORP, original acquisition cost plus cost of improvements greater than \$100,000, etc.).
  - b. Were improvements made to the property in the last 20 years?
  - c. If the answer to b. is yes, were the improvements greater than or equal to \$100,000? (If more than one improvement is made, and the improvements are part of one overall effort, the sum of the costs of the improvements should be capitalized, even if the efforts are separately funded.)
  - d. For those improvements greater than or equal to \$100,000, conduct the following steps:
    - (1) Determine what support exists for the cost of the improvement. Verify the cost back to source documents.
    - (2) Obtain a copy of the DD 1354, Transfer and Acceptance of Military Real Property.
    - (3) Verify that the improvement meets the criteria for capitalization per DoD Financial Management Regulation, Volume 4, Chapter 6, Paragraph 060205 A, which states, "Consistent with the SFFAS No. 6 'Accounting for Property, Plant and Equipment,' costs to improve PP&E shall be capitalized only when the improvement increases a General PP&E asset's capacity, size, efficiency, or useful life."
    - (4) Verify the physical existence of the improvement.

- (5) Identify the recorded acquisition date of the improvement. Does it appear to agree with the apparent physical age of the improvement?
- (6) For all ORP improvements greater than or equal to \$100,000 that have not exceeded their useful lives (i.e., those less than 20 years), summarize the improvements by age of the improvement and total cost on the “ORP Age Summary” Excel worksheet as follows:

<u>Age of Improvement</u>	<u>Quantity</u>	<u>Cost</u>
Less than 1 year		
> = 1, < 2 years		
> = 2, < 3 years		
> = 3, < 4 years		
> = 4, < 5 years		
...		
> = 19, < 20 years		

- (7) Summarize the following information for each location reviewed and for each improvement that meets the capitalization threshold:
  - (a) Contractor Name
  - (b) Contract Number on DD 1662
  - (c) Property Owner
  - (d) Location of Facility
  - (e) Type of Facility
  - (f) Building Number
  - (g) Date of the Improvement
  - (h) Cost of the Improvement
  - (i) Cost of the Real Property (including improvements)
  - (j) Other Identifying Information
- (8) Input data on the “ORP List” Excel worksheet. Provide a list of the verified improvements to Headquarters, PSP, as soon as the list is finalized (prior to completion of the entire review of government property, if possible) to be forwarded to the Services, through the Comptroller’s office, for their verification in the real property database.

- |  | <u>Staff Hours</u> | <u>Budget</u> | <u>Actual</u> | <u>Ref.</u> | <u>Auditor<br/>Initial<br/>&amp; Date</u> |
|--|--------------------|---------------|---------------|-------------|---|
|--|--------------------|---------------|---------------|-------------|---|
4. Contractor Acquired Material (CAM) and Government  
Furnished Material (GFM)
- a. If the contractor separately accounts for CAM and GFM as inventory, work-in-process, and finished goods, obtain a breakout by area for CAM and GFM, separately, for all contracts reported. If the information is unavailable, determine what would be required by the contractor to provide the requested breakout (e.g., system changes, labor costs, etc.).
  - b. Determine whether the value of work in process (WIP) and/or finished goods is included on the DD 1662.
  - c. For those sampled CAM items selected for evaluation:
    - (1) Determine the purpose of the CAM , i.e. would it be categorized as:
      - (a) Material to be incorporated into the end product or consumed in the production of items for the contract
      - (b) Material to be consumed in a repair process
      - (c) Material managed or stored for a DoD component
      - (d) Excess material
      - (e) Obsolete material
      - (f) Material held for future use
      - (g) Other material (explain)
    - (2) For CAM categorized as (c) or (f), provide the following information:
      - (a) Contractor Name
      - (b) Contract Number on DD 1662
      - (c) Property Owner
      - (d) National Stock Number
      - (e) Nomenclature (description of item)
      - (f) Serial Number
      - (g) Identification Number
      - (h) Amount Reported per DD 1662
      - (i) Date of Document used for Sample
      - (j) Other Identifying Information.

Input data on the "CAM List" Excel worksheet.  
Provide a list of these items to Headquarters, PSP,



as soon as the list is finalized (prior to completion of the entire review of government property, if possible) to be forwarded to the Services, through the Comptroller's office, for their verification in DoD Component systems.

- (3) Determine what support exists for the value of the CAM. Verify value back to source documents.
- (4) For CAM, analyze the amount for accuracy and completeness, i.e., were all applicable costs (e.g., labor, labor overhead, material overhead, and G&A) and negotiated fee included in the cost reported for the DD 1662. If all costs have not been included, calculate the total amount in accordance with the contractor's disclosed practices. If the item selected is several years old, use the current rates and factors. Summarize the results of the review of all sampled items on the "Material" Excel worksheet.

d. For those sampled GFM items selected for evaluation:

- (1) Determine the purpose of the GFM , i.e. would it be categorized as:
  - (a) Material to be incorporated into the end product or consumed in the production of items for the contract
  - (b) Material to be consumed in a repair process
  - (c) Component parts sent to a contractor for repair
  - (d) Material managed or stored for a DoD component
  - (e) Excess material
  - (f) Obsolete material
  - (g) Material held for future use
  - (h) Other material (explain)
- (2) For GFM categorized as (c) or (d) or (g), provide the following information:
  - (a) Contractor Name
  - (b) Contract Number on DD 1662
  - (c) Property Owner
  - (d) National Stock Number
  - (e) Nomenclature (description of item)
  - (f) Serial Number

- (g) Identification Number
- (h) Amount Reported per DD 1662
- (i) Date of Document used for Sample
- (j) Other Identifying Information.

Input data on the "GFM List" Excel worksheet.  
Provide a list of these items to Headquarters, PSP, as soon as the list is finalized (prior to completion of the entire review of government property, if possible) to be forwarded to the Services, through the Comptroller's office, for their verification in DoD Component systems.

- (3) Determine what support exists for the value of the GFM. In those cases where the government has not furnished the unit price on the shipping document determine if the contractor has taken action to obtain the information.
- (4) Summarize the results of the evaluation of all CAM and GFM sampled items on the "Material" Excel worksheet under the CAM and GFM tabs, respectively.

#### **D. Concluding Evaluation Steps**

1. Summarize the results of the evaluation on the Excel worksheets as referenced throughout the evaluation program.
2. Discuss the results of the evaluation with your supervisor and the regional point of contact.
3. Draft a memorandum detailing the results of the evaluation. The memorandum should include the Excel worksheets transmitted in the Excel format. To facilitate our efforts to summarize the information at the DCAA Headquarters level, FAOs should include the contractor's name and Cage Code in the title of the submitted Excel worksheet.
4. Provide a copy of the draft results memorandum to the government property administrator prior to the exit conference.
5. Hold an exit conference with the contractor.

<b>DoD Standard Recovery Periods</b>	<b>DD 1662 Line No.</b>	<b>Recovery Period</b>
General Purpose Vehicles (Includes Heavy Duty Trucks & Buses), ADP Systems and Hardware (Computers and Peripherals), High Tech Medical Equipment, Equipment Used in RDT&E, Radio and Television Broadcasting Equipment, and Software**	12-15	5 Years*
Improvements to Personal Property (Equipment & Machinery)	12-15	5 Years
All Other Equipment, Machinery and Software**	12-15	10 Years
Improvements to Fences, Roads, Bridges, Sewers and other Utilities, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities, etc	11	10 Years
Improvements to Leased Buildings and Other Real Property	11	Remainder of Lease Period
Vessels, Tugs, Barges and Similar Water Transportation Equipment (non-National Defense PP&E vessels/ships)	12 & 13	20 Years
Steam (12.K pounds per hour or more) and Electric Generation Equipment (500 Kilowatt or more) and Other Utilities	12 & 13	20 Years
Improvements to Buildings, Hangers, Warehouses, Air Traffic Control Towers, and Other Real Property Structures	11	20 Years
Fences, Roads, Bridges, Sewers, and other Utilities, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities, etc.)	11	20 Years
Buildings, Hangars, Warehouses, Air Traffic Control Towers, and Other Real Property Structures	11	40 Years

\*A recovery period of less than 5 years is permitted, when the acquiring DoD Component is certain that the useful life of an asset is at least 2 years but less than 5 years. In such instances, the recovery period shall be the known useful life (2-4 years, as appropriate).

\*\* Depending on the nature of the software, it can be depreciated over a period of less than 5 years, 5 years or 10 years. The determining factor should be the actual estimated useful life of the software consistent with that used for planning the software's acquisition.

Source: DoD Financial Management Regulation, Volume 4, Chapter 6, Paragraph 060206 I, Table 6-7.

## **INSTRUCTIONS FOR RECORDING DATA ON THE EXCEL WORKSHEETS**

### **General PP&E:**

The General Property, Plant & Equipment (PP&E) personal property consist of Other Plant Equipment, Industrial Plant Equipment, Special Tooling, and Special Test Equipment. The results of the evaluation of General PP&E should be entered on the attached Excel worksheet "General PP&E.xls." **All** reviewed items should be recorded on this worksheet. This worksheet contains a separate tab for each category of General PP&E. Each separate tabbed worksheet is further divided into three parts: Sampled Items, Stratified Items, and General Information. Please record the information on the worksheet, as indicated, for each part reviewed. The worksheets contain formulas that calculate the audit determined accumulated depreciation and net book value for each part reviewed. If the asset age is greater than the asset category service life, the formula automatically makes accumulated depreciation equal to the audit determined acquisition cost and net book value equal to zero. If the item selected for review is less than \$100,000, enter zero in the accumulated depreciation and the Net Book Value columns. If improvements greater than \$100,000 were made to the General PP&E item, report these items as a separate line item on the worksheet and indicate that it is an improvement.

For sampled items, enter the following additional information: 1) type of sample: statistical (dollar unit sampling or physical unit sampling) or judgmental; 2) total universe: total number of items and total value of sampling units before stratification; 3) sampling frame: hardcopy computer listing, electronic file, etc.; 4) sampling frame totals: total number of items and total value of sampling units in strata. If the auditor reviewed the total universe electronically as of 9/30/99, it is not necessary to enter real time sampling frame totals. However, if the auditor reviewed electronic files real time or only a portion (or none) of the universe electronically, the real time sampling frame totals and/or the sampling frame totals as of 9/30/99 must be entered so that adjustments can be made during sample evaluation; and 5) sample size: self explanatory.

If the sampling frame is hard copy and large dollar items are judgmentally stratified for review, enter the indicated information for the stratified parts under the section for stratified items.

In addition, if the auditor reviewed electronic files (or if the information can be computed easily from hardcopy records), please enter the indicated information for the total universe under the section for general information.

Finally, for those items reviewed that are \$100,000 or greater, record the quantity and cost by age for 5 year property and 10 year property on the attached Excel worksheet "GPP&E Age Summary.xls." This worksheet also has a separate tabbed worksheet for each of the categories of GPP&E.

### **National Defense PP&E:**

The National Defense PP&E items sampled for review should be listed on the Excel worksheet “ND PP&E List.xls.” It is important that the Property Owner be identified for each sampled item. Also, if the auditor cannot identify a National Stock Number, Serial Number or other Identification Number, any other identifying information should be indicated on the worksheet.

### **Other Real Property Improvements:**

The items sampled for review should be listed on the Excel worksheet “ORP List.xls.” It is important that the Property Owner be identified for each sampled item. Also, if the auditor cannot identify a Building Number, any other identifying information should be indicated on the worksheet.

In addition, for the Real Property Improvements selected for review and verification, record the quantity and cost by age of improvement on the attached Excel worksheet “ORP Age Summary.xls.”

### **Contractor Acquired Material (CAM) and Government Furnished Material (GFM):**

The results of the evaluation of Material should be entered on the attached Excel worksheet “Material.xls.” This worksheet contains a separate tabbed worksheet for each category of material. Each separate tabbed worksheet is further divided into two parts, Sampled Items and Stratified Items. **All** reviewed items should be recorded on these worksheets. It is important that the purpose of the material and the category of material be indicated on the worksheets.

For sampled items, enter the following additional information: 1) type of sample: statistical (dollar unit sampling or physical unit sampling) or judgmental; 2) total universe: total value of sampling units per 30 September 1999 DD 1662; 3) sampling frame: hardcopy computer listing, electronic file, etc.; 4) sampling frame totals: total value of sampling units. If the auditor reviewed the total universe electronically as of 9/30/99, it is not necessary to enter real time sampling frame totals. However, if the auditor reviewed electronic files real time or only a portion (or none) of the universe electronically, the real time sampling frame totals and/or the sampling frame totals as of 9/30/99 must be entered so that adjustments can be made during sample evaluation; and 5) sample size: self explanatory.

List the material identified under audit step C.4.c(1) as (c) or (f) on the attached Excel worksheet “CAM List.xls.” List the material identified under audit step C.4.d(1) as (c), (d) or (g) on the attached Excel worksheet “GFM List.xls.” It is important that the Property Owner be identified for each sampled item. Also, if the auditor cannot identify a National Stock Number, Serial Number or other Identification Number, any other identifying information should be indicated on the worksheet.

Attachment (*not available online*)

Excel Worksheets

[FAO Name]  
[FAO Region]  
**DEFENSE CONTRACT AUDIT AGENCY**  
[FAO Address]

MEMORANDUM FOR ASSISTANT DIRECTOR, POLICY & PLANS,  
HEADQUARTERS, DCAA

**ATTENTION: Special Projects Division/Sue Quinlan**

**SUBJECT: Application of Agreed-Upon Procedures**  
[Contractor Name]  
**Government Property and Material in the Possession of Contractors**

As requested by DCAA Headquarters, Policy & Plans in MRD 00-PSP-XXX(R) dated XX May 2000, we applied agreed-upon procedures to the books and records of [**contractor name**]. The purpose of our engagement was to collect information on DoD property in the possession of contractors to assist the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) in developing sound policies for financial statement reporting.

We have performed the mutually agreed upon procedures enumerated below to assist the OUSD(C) in developing sound policies for financial statement reporting. This agreed-upon procedure engagement was performed in accordance with generally accepted government auditing standards. The sufficiency of the procedures is solely the responsibility of the OUSD(C). Consequently, DCAA makes no representation regarding the sufficiency of the procedures described below, either for the purpose for which this memorandum has been requested or for any other purpose.

The following agreed-upon procedures were applied: [**modify as appropriate**]

- We reviewed the contractor's policies and procedures for accounting for :
  - Government Property, Plant, and Equipment (GPP&E) Personal Property,
  - Agency Peculiar Property (National Defense PP&E),
  - Real Property Improvements, and
  - Contractor Acquired Material (CAM) and Government Furnished Material (GFM);
- We evaluated, on a sample basis, the supporting data for the amounts reported for GPP&E, CAM, and GFM on the DD Form 1662, DoD Property in the Possession of Contractors as of 30 September 1999 [**or another date if current data was used**] and we verified the physical existence of the sampled parts, as appropriate;
- We obtained a current list of all Agency Peculiar Property (ND PP&E) in the contractor's possession and verified the physical existence of the property on a sample basis; and

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- We evaluated, on a sample basis, the supporting data for the cost of Real Property Improvements greater than or equal to \$100,000 and we verified the physical existence of the improvements.

*[Note any restrictions on procedures]*

**This memorandum pertains only to the performance of agreed-upon procedures to collect information on DoD property in the possession of contractors. We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.**

The application of agreed-upon procedures disclosed the following:

1. *[Describe the results of the review of the contractor's policies and procedures for each category of property reviewed, as applicable.]*
2. *[Describe the results of the evaluation of General PP&E Personal Property. Provide a summary of the total universe for each category of GPP&E {dollars and number of items} along with the summary of the sampled parts {dollars and number of items}. Attach the appropriate Excel spreadsheets detailing the results of the evaluation as referenced in the audit program.]*
3. *[Describe the results of the evaluation of the Agency Peculiar Property {National Defense PP&E}. Provide a summary of the verified property {dollars and quantity}. Attach the appropriate Excel spreadsheet detailing the results of the evaluation as referenced in the audit program.]*
4. *[Describe the results of the evaluation of Real Property Improvements. Provide a summary of the verified improvements. Attach the appropriate Excel spreadsheets detailing the results of the evaluation as referenced in the audit program.]*
5. *[Describe the results of the evaluation of Contractor Acquired Material {CAM} and Government Furnished Material {GFM}. Provide a summary of the total universe for each category of material {dollars} along with the summary of the sampled parts {dollars}. Attach the appropriate Excel spreadsheets detailing the results of the evaluation as referenced in the audit program.]*

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## **Example**

We provided and discussed the results of this application of agreed-upon-procedures with [name and title of contractor representative] on [date].

Questions regarding this memorandum should be directed to the undersigned or [Supervisory Auditor Name], at [Telephone Number] or [E-mail Address] or the regional representative [Name] at [Telephone Number] or [E-mail Address].

[FAO Manager]  
[Title]  
DCAA [FAO]

### Enclosures – 9 (*not available online*)

1. Excel Spreadsheets – General PP&E.xls
2. Excel Spreadsheets – GPP&E Age Summary.xls
3. Excel Spreadsheet – ND PP&E List.xls
4. Excel Spreadsheet – ORP List.xls
5. Excel Spreadsheet – ORP Age Summary.xls
6. Excel Spreadsheets – Material.xls
7. Excel Spreadsheet – CAM List.xls
8. Excel Spreadsheet – GFM List.xls

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